2
The Meaning and Measurement of International Competitiveness

Harry Bloch and Peter Kenyon*

Introduction

Discussions of economic policy and performance focus increasingly on the concept of international competitiveness. The enormous growth in world trade over recent decades means that the forces influencing trade between countries have substantial impact on the well-being of all citizens of modern economies. International competitiveness has become the catchphrase used to describe the ability to achieve desired outcomes in this era of globalization. However, with this popularity has come a fair degree of confusion. So much so that one of the world’s leading economists in international economics has concluded that the term when applied to cross-country comparisons ‘…is a largely meaningless concept’ (Krugman, 1996, p. 17). Part of this confusion is the implied hypothesis that in order to achieve increased living standards, countries must be able to successfully participate in this growth in international trade and that somehow this is a competitive struggle among countries, with winners and losers, both internationally and domestically.¹

Fagerberg (1988, p. 355) defines international competitiveness broadly as ‘the ability of a country to realise central economic policy goals, especially growth in income and employment, without running into balance-of-payments difficulties’. Our approach is to provide a focus to the discussion of international competitiveness by relating its meaning and measurement to the economic analysis of the forces that determine

* We are grateful to our discussant, Jakob Madsen, and other participants at the Creating an Internationally Competitive Economy conference for helpful comments and suggestions. Not all of the suggestions have been followed and complete responsibility for any errors or oversights remains with the authors.
international trading patterns. Analysis of the forces that determine international trade can be traced back at least as far as to the founder of modern economics, Adam Smith. In *The Wealth of Nations*, Smith ([1776] 1937) identifies differences in the productivity of labour across countries as providing the impetus for trade. He then demonstrates that all countries stand to gain from trade based on differences in productivity.

Differences in productivity across countries play a key role in modern discussions of international competitiveness and in the measurement of competitive advantage. However, the range of factors considered in assessing international competitiveness now extends beyond labour productivity. Our aim in this paper is to utilize economic analysis to identify a range of factors that might affect patterns of international trade and the distribution of gains from this trade. We then consider how to quantify the influence of these factors to obtain measures of international competitiveness.²

Traditional approaches to the analysis of international trade by economists are reviewed in the next section. We start with Smith’s analysis of absolute advantage, before considering David Ricardo’s analysis of comparative advantage and the neoclassical analysis of trade with general equilibrium. Each of these analyses examines the determinants of balanced trade, where the value of exports equals the value of imports. We close that section with the analysis of situations where trade is unbalanced, due to either offsetting private capital flows or government intervention in foreign exchange markets.

Recent developments in the economic analysis of international trade have focused on the role of imperfect competition. With imperfect competition, a country can improve its well-being through strategic intervention in product markets. This has led to the development of a literature concerned with the design of strategic trade policy, and in the following section we consider the implications of strategic trade theory for the meaning and measurement of international competitiveness.

Associated with the development of strategic trade theory has been the notion that competition between countries is analogous to competition between companies.³ This view strengthened during the period in which there was apparent success for intervention by governments of some newly-industrializing Asian countries in stimulating export-oriented growth. Paul Krugman (1996) has mounted a scathing attack on this approach, which he terms pop internationalism. The pros and cons of pop internationalism and their implications for the meaning and measurement of international competitiveness are discussed, before we close this chapter with a few observations on the state of play for international competitiveness.